STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
WASCANA ENERGY MARKETING (U.S.), INC.	:	DETERMINATION DTA NO. 817866
for Redetermination of a Deficiency or for Refund of Corporation Tax under Article 9 of the Tax Law for the Years 1994, 1996 and 1997.	:	

Petitioner, Wascana Energy Marketing (U.S.), Inc., Attention: Allan Smith, 12790 Merit Drive, Suite 800, Dallas, Texas 75251, filed a petition for redetermination of a deficiency or for refund of corporation tax under Article 9 of the Tax Law for the years 1994, 1996, and 1997.

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York on October 23, 2001 at 9:15 A.M., with briefs to be submitted by April 12, 2002, which date began the six-month period for the issuance of this determination. Petitioner appeared by R. David Wheat, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (Kathleen D. O'Connell, Esq., of counsel).

ISSUES

I. Whether petitioner was subject to the corporation tax imposed by Article 9 of the Tax Law because it was carrying on its business in New York State.

II. Whether, if petitioner was carrying on its business in New York State, application of the tax imposed by Article 9 would violate the Commerce Clause of the United States Constitution.

FINDINGS OF FACT

1. During the years in issue, petitioner, Wascana Energy Marketing (U.S.), Inc., was a Delaware corporation solely engaged in the business of purchasing and selling oil and natural gas imported from Canada to its customers in the United States. Its indirect parent, Wascana Energy, Inc. ("the parent corporation"), was a publicly traded entity on the Toronto Stock Exchange. The parent corporation owned 100 percent of a United States holding company called Wascana Corp. which owned 100 percent of petitioner's stock. The parent corporation also owned 100 percent of the stock of Wascana Energy Marketing, Inc., a Canadian corporation ("Wascana Canada").[1]

2. For the years 1993, 1995, 1996 and 1997, petitioner filed New York State corporation franchise tax reports under Article 9-A of the Tax Law. On each of these returns, petitioner's address was shown as 1777 Victoria Avenue, Regina, Saskatchewan, Canada S4P 3C4. Its principal business activity was shown as oil and gas marketing.

3. In November 1998, the Division of Taxation ("Division") began a desk audit of petitioner's corporation franchise tax reports for the years 1994 through 1997. In a letter to petitioner dated November 4, 1998, the Tax Technician assigned to the audit, Deborah Delvecchio, requested a description of petitioner's business activities and the amount of petitioner's gross receipts from each activity. In a letter received by the Division on December 3, 1998, petitioner informed the Division that all of the gross receipts reported on the New York corporation franchise tax reports were from the sale of natural gas.

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[1] Wascana Canada was merged with the parent corporation on January 1, 1996. Wascana U.S. was combined with CXY Energy Marketing U.S.A., Inc. on December 31, 1997. The parent corporation was purchased by Canadian Occidental Ltd. in 1997 and later changed its name to Nexen.

4. Based on petitioner's response, Ms. Delvecchio concluded that petitioner was subject to Article 9 of the Tax Law (familiarly known as the "gross receipts tax") and asked petitioner to file amended returns under sections 186 and 186-a of Article 9.

5. Petitioner submitted completed tax returns under section 186-a of the Tax Law which imposes a tax on corporations furnishing utility services in New York State. However, in a letter signed by Allen Smith, Tax Manager, and dated March 10, 1999, petitioner asserted that all of its sales of natural gas were made for resale. Based on that fact, Mr. Smith took the position that petitioner's sales were shielded from state taxes by Federal Public Law No. 86-272 and that petitioner should never have filed any tax returns in New York State.

6. By letter dated April 5, 1999, Ms. Delvecchio informed Mr. Smith that the Division agreed with his position that petitioner was not subject to tax under section 186-a of the Tax Law. She explained the Division's position that petitioner was subject to the tax imposed by section 186 of the Tax Law, the tax on corporations "principally engaged in the business of supplying . . . gas [through mains or pipes]." The Division based this conclusion on the information supplied by petitioner in its previous letters and its filed corporation franchise tax returns. Petitioner was asked to file amended forms CT-186 for each of the audit years.

7. From May until September 1999, Ms. Delvecchio and Mr. Smith continued to exchange letters regarding petitioner's tax status in New York State. Ms. Delvecchio continued to reiterate the Division's position that petitioner was subject to tax under section 186 of the Tax Law, and she repeatedly asked petitioner to file amended tax forms CT-186 for the years under audit. Mr. Smith continued to argue that petitioner was not subject to New York State tax citing to various Advisory Opinions of the Commissioner, to Public Law No. 86-272 and finally to the Commerce Clause of the United States Constitution.

8. The Division issued a Statement of Audit Adjustment to petitioner on October 18, 1999, asserting tax due under Article 9 of the Tax Law in the following amounts: for the year ended December 31, 1994, a tax due of $56,250.00; for the year ended December 31, 1996, a tax due of $41,974.00; and for the year ended December 31, 1997, a tax due of $233,631.00.

9. In response to Mr. Smith's request for information regarding the actual calculation of the tax due, the Division explained that the tax was estimated based upon information contained in petitioner's filed corporation franchise tax returns (forms CT-3) and letters to the Division. Ms. Delveccio also explained that the tax due for 1994 was estimated as follows: "1994: no report filed. Estimated tax due of $50,000 plus 12 1/2% surcharge."

10. On January 10, 2001, the Division issued to petitioner a Notice of Deficiency asserting tax due under Article 9 of the Tax Law in the same amounts and for the same periods as stated in the Statement of Audit Adjustment previously issued. Penalties were imposed for each year and interest was calculated accordingly.

11. Petitioner sold natural gas to utilities and other wholesalers of natural gas but never sold to end users of that gas.

12. The parent corporation, or Wascana Canada, purchased gas from Canadian producers and arranged to have it shipped by TransCanada Pipelines Ltd. ("TransCanada"), either to a destination in Canada or to the international border. Most of the natural gas sold by the parent corporation and Wascana Canada was sold in Canada. Some portion of the gas was sold to customers in the United States.

13. Petitioner was the importer of record for sales of natural gas where title to the gas passed in the United States. Petitioner was assigned an importer number by the United States

Customs Service, held an import authorization from the United States Department of Energy and made the required regulatory filings with the Department of Energy.

14. Petitioner imported the gas into the United States partly as a service to its customers who did not have import authorization and who did not want to maintain the records required by Federal regulators. Petitioner imported gas into the following states in addition to New York: Iowa, North Dakota, Nebraska, Idaho, Oregon, Washington, Kansas, Texas, Montana, Michigan, and Minnesota. Its accounting records show that sales made to customers taking possession of the gas in New York amounted to 10.29% of petitioner's total sales in 1994, 3.91% of petitioner's total sales in 1996 and 18.43% of its total sales in 1997.

15. Petitioner had no contracts to transport gas in the State of New York.[2] The parent corporation or Wascana Canada entered into contracts with TransCanada to transport natural gas to the international border. Petitioner took title to the natural gas from its parent corporation or Wascana Canada at the international border. Custody of the gas was transferred from TransCanada to a United States pipeline at an interconnect point between the two pipelines. From that point, the gas was transported by a domestic pipeline. Interconnect points in New York State were located in Niagara, Chippawa, and Waddington, New York. The name of the Waddington interconnect point was later changed to Iroquois. These interconnect points are shown on a TransCanada map of marketing and sales.

16. Title to the natural gas sold in New York State passed from petitioner to its New York State purchasers at a delivery point (a point mutually agreed upon between petitioner and its customer) located in New York State. Petitioner held title to the gas and bore the risk of loss and

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[2] Although petitioner had customers in other states, all future references to gas imported and sold refers to import and sale in New York unless specified otherwise.

all other liabilities for the gas from the time it took possession of it at the international border until the gas was transferred to the receiving pipeline at the delivery point. Usually, the gas was transferred by whichever United States pipeline was connected to TransCanada's pipelines at a particular delivery point. If more than one pipeline was connected to TransCanada pipelines, the gas would be transported by the pipeline selected by the customer.

17. During a portion of the audit period, petitioner utilized a Master Sales/Purchase Agreement ("Master Contract"). Section 1 of the Master Contract defines various terms used in the contract as follows: the term "Delivery Point" means "the delivery point(s) specified in the Confirmation Form;" the "Confirmation Form" means "a written notice substantially in the form of Schedule 'A' hereto confirming the specific terms of a Transaction;" "Downstream Pipeline means the pipeline(s) or facilities as described in the Confirmation Form receiving gas at the Delivery Point." Other pertinent provisions of the Master Contract include the following:

> 4. **TRANSPORTATION AND NOMINATION**
>
> (a) Seller shall be responsible for obtaining transportation service to the Delivery Point. Buyer shall be responsible for obtaining transportation service from the Delivery Point. Each party covenants and agrees to maintain in place throughout the term of a Transaction, the transportation service for which it is responsible.
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> (b) Buyer or its designated agent, shall communicate by facsimile its nomination of gas in accordance with the nomination requirements of both the Upstream Pipeline and the Downstream Pipeline. Seller shall immediately acknowledge the nomination if required. If no such nomination by Buyer, as aforesaid, the last nomination shall remain in effect for the duration of the Transaction until a further nomination is made pursuant to this subclause 4(b).
>
> 5. **TITLE TRANSFER AND MEASUREMENT**
>
> Title to and risk of loss of gas delivered and purchased hereunder shall pass to Buyer from Seller at the Delivery Point. The quantity and heating value of gas delivered hereunder shall be measured at the Delivery Point.

Two Schedule "A" confirmation forms attached to the Master Contract placed in evidence

show the delivery point as "Niagara@Tennessee." A third confirmation form shows the delivery point as Waddington.

18. A second contract used by petitioner in 1997 and 1998 is named "Base Contract for Short-Term Sale and Purchase of Natural Gas" (the "Base Contract"). It defines "Delivery Point(s)" to "mean such point(s) as are mutually agreed upon between Seller and Buyer as set forth in the Transaction Confirmation" (Base Contract, § 2.12). One confirmation letter attached to the Base Contract shows delivery points as "Niagara." Another confirmation form shows the delivery point as "Niagara@Tennessee." Other relevant definitions are as follows: "Receiving transporter" is defined as "the Transporter receiving Gas at a Delivery Point, or absent such receiving Transporter, the Transporter delivering Gas at a Delivery Point;" the "Transporter(s)" mean all Gas gathering or pipeline companies, or local distribution companies, acting in the capacity of a transporter, transporting Gas for Seller or Buyer upstream or downstream, respectively, of the Delivery Point pursuant to a particular Transformation Confirmation." Other pertinent provisions of the Base Contract include the following:

> 4.1 Seller shall have the sole responsibility for transporting the Gas to the Delivery Point(s) and for delivering such Gas at a pressure sufficient to effect such delivery but not to exceed the maximum operating pressure of the Receiving Transporter. Buyer shall have the sole responsibility for transporting the Gas from the Delivery Point(s).
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> 4.2 The parties shall coordinate their nomination activities, giving sufficient time to meet the deadlines of the affected Transporter(s). Each party shall give the other party timely prior notice, sufficient to meet the requirements of all Transporter(s) involved in the transaction, of the quantities of Gas to be delivered and purchased each Day. Should either party become aware that actual deliveries at the Delivery Point(s) are greater or lesser than the Scheduled Gas, such party shall promptly notify the other party.
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> 4.3 The parties shall use commercially reasonable efforts to avoid imposition of any Imbalance Charges. If Buyer or Seller receives an invoice from a Transporter that includes Imbalance Charges, the parties shall determine the validity as well as the cause of such Imbalance Charges. If the Imbalance Charges were incurred

> as a result of Buyer's actions or inactions (which shall include, but shall not be limited to, Buyer's failure to accept quantities of Gas equal to the Scheduled Gas) then Buyer shall pay for such Imbalance Charges, or reimburse Seller for such Imbalance Charges paid by Seller to the Transporter. If the Imbalance Charges were incurred as a result of Seller's actions or inactions (which shall include, but shall not be limited to, Seller's failure to deliver quantities of Gas equal to the Scheduled Gas), then Seller shall pay for such Imbalance Charges, or reimburse Buyer for such Imbalance Charges paid by Buyer to the Transporter.
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> * * *
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> All Gas delivered by Seller shall meet the quality and heat content requirements of the Receiving Transporter.

18. Petitioner's witnesses testified that petitioner took title to the natural gas at the international border and immediately sold the gas, that title to the gas passed as soon as the gas was transferred from TransCanada to a United States pipeline on the New York side of the border.

19. Petitioner's parent contracted for the transportation of natural gas over TransCanada pipelines pursuant to a fixed transportation contract.

20. Through November 1, 1994, the fixed transportation contract with TransCanada called for the transportation of 125 million cubic feet of natural gas per day to the Niagara interconnect point. Subsequent to November 1, 1994, the contract called for the transportation of 42 million cubic feet of natural gas per day to the Niagara interconnect.

21. Petitioner's actual New York receipts were $17,072,527.44 in 1994. Petitioner reported New York receipts of $52,868,435.00 in 1993. Petitioner reported New York receipts of $467,600.00 in 1995.

22. Petitioner's revenues from sales of natural gas to New York State purchasers totaled $41,251,656.35 for the period January 1, 1994 through June 30, 1997. After June 30, 1997, petitioner continued to derive revenue from sales of natural gas in New York.

23. Petitioner had a registered office in Washington, D.C. Its operations were managed from Calgary, Alberta, Canada. It was not registered to do business in New York.

24. Petitioner located its customers primarily through publicly available information. Petitioner identified potential United States customers by determining who had transportation capacity on pipelines that reached the Canadian border at the points where petitioner would have gas available for sale. Some of these customers, such as Connecticut Natural Gas, would transport the gas from the New York delivery point to points out of state using transportation that it had contracted for, for instance, using Tennessee Gas Pipeline.

25. Petitioner also found customers through other types of public information, for example, by searching "Who's Who in Natural Gas."

26. Petitioner did not conduct advertising, solicitation or marketing in New York State, and no agents, representatives or independent contractors did so on petitioner's behalf.

27. Once a customer had been located, all contracts for the sale and purchase of natural gas were negotiated and executed from petitioner's offices in Canada. Typically, petitioner and the customer signed a master purchase/sales contract. The exact terms of that contract were documented by completion of a "Schedule A." Petitioner would send a copy of the standard master contract to the customer either by fax or mail. All negotiations were conducted over the telephone or in person by petitioner's personnel in Houston, Texas or Canada. The finalized contract was signed in Calgary, Alberta, Canada, by two of petitioner's officers and sent to the customer. In accordance with these master contracts, a Schedule A outlining the terms of a particular sale would be negotiated over the telephone and the completed form would be faxed to the customer. The customer would fax a signed copy of the Schedule A back to petitioner's office in Canada.

28. No employee, agent, representative or independent contractor of petitioner entered New York State to negotiate or execute any contracts within New York State including the Schedule A.

29. Petitioner and its affiliates did not own, lease, or use any tangible, intangible or real property in New York State.

30. Petitioner had no employees, agents, representatives or independent contractors based in or working in New York State.

31. Petitioner had a policy against conducting business in New York State and was not registered to do business in New York State. This policy was adopted on advice of petitioner's accountants.

32. Petitioner did not maintain a bank account in New York State; its bank account was in Regina, Saskatchewan, Canada.

33. Billing invoices for sales to destinations in New York were prepared and mailed outside of New York. Billing invoices were mailed to the address of record for a particular customer. Customers who took possession of natural gas in New York did not necessarily have business offices in New York, so the invoices were not always mailed to addresses in New York.

34. Petitioner submitted 23 proposed findings of fact. The Division made no objection to any of the proposed findings. They have been substantially incorporated into the above findings of fact. The Division submitted 41 proposed findings of fact. Petitioner objected to 14 of the proposed findings of fact. The grounds for each of petitioner's objections and the ruling on each objection are as follows:

a. Proposed finding of fact "2" states that "petitioner was formed for or principally engaged in the business of supplying gas." This fact assumes a legal conclusion as petitioner

contends. The fact is restated in finding of fact "6" to clarify that this was the Division's position on audit.

b. Petitioner objects to proposed finding of fact "7" on the ground that the facts contained therein are irrelevant and derived from the affidavit of a Division employee not available for cross-examination. Proposed finding of fact "7" has been restated as finding of fact "9" to more completely and accurately reflect the record. The basis for finding of fact "9" is a letter from Ms. Delvecchio to Mr. Smith.

c. Proposed findings of fact "8," "9","10," "13," and "15" set forth the amounts of petitioner's New York receipts and revenues derived from sales of gas imported into New York. Petitioner objects to these facts on the grounds of relevance. Whether these facts are relevant to determining whether taxation of petitioner by New York violates the Commerce Clause is a matter of law. The Division takes the position that the amount of the receipts and revenues are relevant considerations. These facts have been incorporated into this determination. The legal import of those facts will be considered in the Conclusions of Law.

d. Proposed findings of fact "20" through "23" paraphrase portions of petitioner's contract for Short Term Sale and Purchase of Natural Gas. Petitioner claims that the Division paraphrases are misleading and in some cases irrelevant. To more accurately reflect the record, the pertinent provisions of the contract have been quoted directly. As above, the relevance of these provisions will be considered in the Conclusions of Law.

e. Petitioner objects to proposed finding of fact "39" because it inaccurately suggests that all customers who took title to gas in New York had New York billing addresses. This does not reflect the facts in the record and has not been accepted.

f. Proposed finding of fact "40" does not accurately reflect the testimony of petitioner's witness, Rodney Rice, and has not been adopted.

g. Proposed finding of fact "41" paraphrases a provision of the sales contract. The entire provision has been quoted to more accurately reflect the record.

35. Petitioner did not address Division's proposed finding of fact "19" in that section of its brief where objections were made to the Division's findings of fact. However, it devoted an entire section of its brief to refuting that fact. Because it is not supported by substantial evidence in the record, I have not adopted Division's proposed finding of fact "19." The remainder of the Division's proposed findings of fact have been substantially incorporated into this determination.

CONCLUSIONS OF LAW

A. In its brief, the Division made several factual assertions which were contested by petitioner. Before discussing the legal issues in contention, it is first necessary to resolve these factual questions.

The first question to be resolved is where title to the natural gas passed from petitioner to its customers. Under both contracts in use during the audit period, title passed at the "Delivery Point" (Master Contract, § 5; Base Contract § 8.1). Throughout this proceeding, petitioner has asserted that the Delivery Point is the interconnect point between TransCanada pipelines and United States pipelines in New York. Petitioner's witnesses testified that these interconnect points were within New York's borders but only inches from the international border; that petitioner purchased natural gas at the international border; that the gas was immediately transferred to the custody of a United States pipeline and that title to the gas was passed concurrently to a United States customer. For the first time in its brief, the Division asserts that the Delivery Point is actually the metering station of the receiving United States pipeline located

well within the borders of New York and not immediately on the other side of the international border.

The Division's argument begins with an interpretation of the contract language. Section 5 of the Master Contract states: "Title and risk of loss of gas delivered and purchased hereunder shall pass to Buyer from Seller at the Delivery Point. *The quality and heating value of gas delivered [pursuant to the Master Contract] shall be measured at the Delivery Point*" (emphasis added). Based on this language, the Division asserts that "[t]he 'Delivery Point' is the point in New York State at which the quantity and heating value of the gas delivered under the contract '*shall* be measured'" (Division's proposed finding of fact "19", quoting section 5 of the Master Contract; emphasis in Division's brief). The Division notes that the boundary between the New York portion of the United States and Canadian border is located on a line which is in the middle of the Niagara River (where the Niagara and Chippawa interconnects are located), the middle of Lake Ontario and the middle of the St. Lawrence River (where the Iroquois interconnect is located). Since the gas could not be measured in the middle of the river, the Division argues that the Delivery Point would have to be at the receiving pipeline's metering station in New York State. Thus, the Delivery Point would be well into New York and not inches from the international border as petitioner contends, and the gas would continue to be owned and possessed by petitioner during that period in which it was measured and tested.

The Division's interpretation of the contract is not supported by the language of the contract or by other evidence in the record. The term "Delivery Point(s)" is defined in the definitions sections of both the Master Contract and the Base Contract (Master Contract § 1; Base Contract § 2.12). The second sentence of section 5 of the Master Contract does not purport to be a definition of "Delivery Point," and inasmuch as a definition is included in each of the

contracts, it is inappropriate to look to the second sentence of section 5 to interpret the term "Delivery Point(s)" as the Division does. In addition, the language relied on by the Division does not exist in the Title section of the Base Contract which was in effect in one of the audit years, 1997.

The definitions of "Delivery Point(s)" in the contracts make no mention of measuring or testing the gas, rather the "Delivery Point" is the point "specified in the confirmation form." While few confirmation documents were placed in evidence, three of those that were show the Delivery Point as "Niagara@Tennessee," i.e., at the Tennessee pipeline in Niagara. Inasmuch as the Tennessee pipeline begins where the TransCanada pipeline ends, the Delivery Point is the interconnection between the TransCanada and Tennessee pipelines. The exact place where petitioner contends that title to the gas was passed.

Under the terms of both contracts, petitioner is responsible for obtaining transportation service to the Delivery Point and the buyer is responsible for obtaining transportation service from the Delivery Point. Since petitioner never entered into any transportation contracts and its affiliated corporations had no contracts to transport natural gas in New York, it had no ability to transport the gas once custody of the gas was transferred from TransCanada to the transporting United States pipelines. If the Delivery Point was necessarily at metering stations in New York, as the Division claims, petitioner would have been incapable of performing under these contracts since it had no ability to transport the gas from the international border to the metering stations.

In sum, the Master Contract, the Base Contract and the confirmation documents establish that title to the natural gas passed in New York at the interconnect points between TransCanada and the United States pipelines.

B. Petitioner's witnesses consistently testified that petitioner took possession of the natural gas at the international border and transferred title and possession to its customers in New York State at the point where TransCanada pipelines interconnect with United States pipelines. At hearing, the Division never challenged this testimony and never raised the theory it advances in its brief, that title passed at metering stations in New York, although it had access to both contracts and was well aware of petitioner's position before the hearing. For the first time in its brief, the Division challenged the witness testimony and claimed that title passed at the metering stations. To support that proposition, it submitted 20 publicly available documents with its brief. The position taken by the Division raises serious questions of fairness.

Although the Division claims that its arguments are based solely on the contract language, an analysis reveals that its interpretation of the contracts relies heavily on facts not in evidence – primarily facts taken from Federal Energy Regulatory Commission ("FERC") orders, Public Service Commission ("PSC") orders and several monographs. In ***Matter of Schoonover*** (Tax Appeals Tribunal, August 15, 1991), the Tribunal held that finality is essential to a fair and efficient hearing system. The Division's citation to public documents to raise factual issues not raised at the hearing violates this basic principal of fairness by not allowing petitioner an opportunity to address factual issues raised after the record was closed. For instance, the Division's argument that title must have passed at the metering stations is partially premised on a monograph describing the construction and calibration of gas meters. Since the monograph is being relied on for certain facts stated in the monograph, the Division is attempting to place facts in the record after the record was closed It is irrelevant that the monograph is publicly available since petitioner had no opportunity to address the facts stated therein or the Division's use of those facts. Moreover, the monograph is irrelevant since it does not address the critical point for

which it is cited: whether the Delivery Point as defined in petitioner's contracts was necessarily at the metering station.

Official notice may be taken of the location of the Canada/United States border, and petitioner agrees that the TransCanada pipelines interconnect with the United States pipelines at that border. These facts are insufficient to prove that title to the natural gas passed at metering stations as the Division contends. That contention is premised in part on the Division's assumption that the contracts required that the gas be metered and tested by the receiving transporter. The contracts do not support that assumption. The Master Contract merely states that the quantity and heating value of the gas "shall be measured at the Delivery Point," and the Base Contract is silent on the point. Although other provisions in the contracts require that the quality and heat content of the gas satisfy the requirements of the receiving transporter, nowhere does the contract require that the gas be measured or tested by the receiving transporter. The Division merely assumes that the receiving transporter rather than TransCanada would meter the gas and test it for quality and heat content. At hearing, petitioner presented the contracts and the testimony of witnesses to establish that title to the gas passed in New York at the interconnect points with TransCanada. Petitioner could not be expected to address questions relating to the metering of the gas, who had responsibility for that metering and where it was typically done since the actual locations of the Delivery Points did not appear to be facts in dispute at the hearing.

For all of the above reasons, Division's proposed finding of fact "19" is rejected as not supported by evidence in the record.

C. The Division further contends that petitioner failed to carry its burden of proof to show that title, responsibility for transportation and risk of loss passed within the state of New York at

the interconnect between TransCanada and the applicable United States pipeline. This contention is also rejected. The Division's claim is based on the rejected premise that title passed at the metering stations of the receiving transporter. The Master Contract, the Base Contract, the confirmation documents, a TransCanada map of its sales and marketing systems and the testimony of petitioner's witnesses establish that title passed at the interconnect points as petitioner asserted. The Delivery Points as defined in the contracts were the interconnect points specified by the confirmation documents.

D. Division's proposed findings of fact “28,” “29” and “30” accurately state that the gas sold by petitioner in New York State was transported pursuant to a fixed transportation contract. In its brief, however, the Division incorrectly states that petitioner was a party to the fixed transportation contracts. It was not. Petitioner's parent corporation entered into fixed transportation contracts with TransCanada for the transportation of natural gas to the international border. Petitioner purchased the gas from its parent or Wascana Canada at the international border. Petitioner never entered into contracts for the transportation of natural gas either in Canada or in the United States. None of the affiliated corporations had contracts for the transportation of natural gas in New York.

E. Contrary to the Division's assertion in its brief, natural gas pipelines are common carriers and were common carriers throughout the audit period. Interstate pipelines became common carriers in October 1985 when FERC issued an "Open Access Order" (Order 436) requiring interstate pipeline companies to use their pipelines to transport natural gas owned by third parties on a nondiscriminatory basis. It is irrelevant that petitioner was in business prior to the issuance of a 1992 FERC deregulation order regarding Tennessee Gas.

F. Before its repeal (L 2000, ch 63, pt Y, § 3, effective May 15, 2000), Tax Law § 186(1) imposed a tax on corporations "formed for or principally engaged in the business of supplying . . . gas . . . delivered through mains or pipes . . . for the privilege of exercising its corporate franchise or *carrying on its business* in such corporate or organized capacity in this state" (emphasis added).[3] Petitioner takes the position that it did not exercise its corporate franchise or carry on its business in New York.

The Division never promulgated regulations defining the term "carrying on its business" as that term is used in Tax Law §186(1). However, regulations have been promulgated under Tax Law § 209(1) which imposes a franchise tax on general business corporations. The pertinent language of section 209(1) is almost identical to that found in Tax Law § 186(1); therefore, the regulations interpreting section 209(1) may be looked to for guidance in determining whether a corporation is "carrying on its business" in New York within the meaning of Tax Law § 186(1).

G. Regulations regarding foreign corporations doing business in New York pursuant to Tax Law § 209(1) (20 NYCRR 1-3.2) state, in pertinent part, as follows:

> (a)(1) The tax is imposed on every foreign corporation, not specifically exempt as provided in section 1-3.4 of this Subpart, whose activities include one or more of the following:
>
> (i) doing business in New York State in a corporate or organized capacity or in a corporate form; or
>
> (ii) employing capital in New York State in a corporate or organized capacity or in a corporate form; or
>
> (iii) owning or leasing property in New York State in a corporate or organized capacity or in a corporate form; or

[3] All references in this determination to the provisions of section 186 may be understood to apply to former section 186 of Article 9 in effect during the assessment period.

(iv) maintaining an office in New York State.

(2) A foreign corporation engaged in New York State in any one or more of the activities described in paragraph (1) of this subdivision is subject to tax even though its activities are wholly or partly in interstate or foreign commerce.

* * *

(4) A foreign corporation engaged in New York State in any one or more of the activities described in paragraph (1) of this subdivision is subject to tax regardless of whether it is authorized to do business in New York State.

H. Petitioner did not employ capital or maintain an office in New York. The only property which it owned in New York was the natural gas which it sold almost at the same moment that the gas entered New York. It did not store the gas or any other inventory in New York. The very brief ownership of gas in New York is not a factor showing that petitioner was carrying on business in New York. Accordingly, the determinative factor is whether petitioner was "doing business" in New York.

The regulations provide a framework for determining whether a foreign corporation is "doing business" in New York.

(b)(1) The term doing business is used in a comprehensive sense and includes all activities which occupy the time or labor of people for profit. Regardless of the nature of its activities, every corporation organized for profit and carrying out any of the purposes of its organization is deemed to be 'doing business' for the purposes of the tax. In determining whether a corporation is doing business, it is immaterial whether its activities actually result in a profit or a loss.

(2) Whether a corporation is doing business in New York State is determined by the facts in each case. Consideration is given to such factors as:

(i) the nature, continuity, frequency, and regularity of the activities of the corporation in New York State;

(ii) the purposes for which the corporation was organized;

(iii) the location of its offices and other places of business;

(iv) the employment in New York State of agents, officers, and employees; and

(v) the location of the actual seat of management or control of the corporation. (20 NYCRR 1-3.2[b].)

I. Petitioner is in the business of buying and selling oil and natural gas. It engages in these activities for profit, thus it is "doing business" (NYCRR 1-3.2.[b][1]). Whether petitioner is carrying on its business in New York is a question that may be answered by applying the five factors listed above. Three of those five factors do not apply to petitioner's business activities in New York. Petitioner has no offices or other places of business in New York (NYCRR 1-3.2[b][2][iii]); has no agents, officers or employees in New York (NYCRR 1-3.2[b][2][iv]); and maintains its managerial and corporate offices in Canada (NYCRR 1-3.2[b][2][v]). Thus, three of the five factors showing a corporation that does business in New York do not apply to petitioner.

The two remaining factors require more extended analysis.

The first and second factors of the regulation are concerned with the nature, frequency and regularity of the foreign corporation's activities in New York (20 NYCRR 1-3.2[b][2][i][ii].) Petitioner's primary business purposes were (1) purchasing natural gas at the international border; (2) importing the gas into the United States; and (3) selling the gas to a United States customer. All of the activities performed by petitioner in furtherance of its corporate purposes were performed in Canada. Marketing to customers with access to pipelines passing through New York took place in Canada. Contracts were negotiated and executed in Canada. The regulatory activities necessary to petitioner's business were performed in Canada. Petitioner's bank account was in Canada. Petitioner did not employ agents or independent contractors to perform any activities on behalf of petitioner in New York. Petitioner's only physical presence

in New York was the natural gas located in New York. It has been found that petitioner's ownership of the natural gas was brief, as title to the gas passed immediately after custody of the gas was transferred from TransCanada to a United States pipeline. Petitioner's New York sales were substantial but they made up only a small portion of its total sales in the United States: 10.29% of total sales in 1994; 3.91% of total sales in 1996; and 18.43% of total sales in 1997.[4]

The Division argues that petitioner undertook regular, systematic and continuous activities to market its product in New York and that by exploiting the New York market, petitioner exposed itself to New York's taxing authority. The Division notes that petitioner imported natural gas into New York and sold it in New York on a daily basis; it sought out customers who had contracts for the transportation of natural gas through pipelines which interconnected with TransCanada pipelines at New York interconnect points; and it profited from sales to those customers.

I cannot agree with the Division that the reach of Tax Law § 186 extends to every utility business which systematically and continuously exploits the New York marketplace. The Division argues that the term "doing business" is broadly defined in the regulations and encompasses petitioner's activities. I agree. But the issue is not whether petitioner was carrying on a business, but whether that business was carried on in New York. When consideration is given to the five factors listed above, it is apparent that petitioner was not carrying on its business in New York. Three of the five factors do not apply at all (20 NYCRR 1-3.2[b][2][iii],[iv],[v]). With reference to the first and second factors, the Division mistakes sales

[4] The Division overemphasizes the significance of petitioner's New York sales by comparing them to sales in the individual states in which petitioner sold gas, for instance, comparing New York sales with sales in Iowa, Oregon and Washington. Even with this method, petitioner's sales in New York outpaced its sales in the next highest state in only one year, 1997. Clearly, however, the regulation contemplates a comparison of New York sales with all other sales and not a state-by-state comparison.

for business activities. A foreign corporation may deliver goods into New York, and thus have sales in New York, without performing any of its business activities in New York. Petitioner's business activities were all performed in Canada (20 NYCRR 1-3.2[b][2][i],[ii]). Petitioner's income from New York sales ranged from 3.9 percent to less than 19 percent of its total income. While these amounts show that petitioner had significant New York sales, they do not show that petitioner was carrying on its business in New York.

In sum, I find that petitioner was not "carrying on its business" in New York during the audit years and, consequently, was not subject to Tax Law § 186.

J. Even if petitioner were found to have been carrying on its business in New York, application of the franchise tax would still be barred by the Commerce Clause of the United States Constitution. The standard now employed to determine the validity of a state tax on interstate commercial activity was first articulated in ***Complete Auto Tr. v. Brady*** (430 US 274, 251 L Ed 2d 326) where the Court set forth four considerations for making such a determination: (1) whether the tax is applied to an activity with a substantial nexus with the taxing state; (2) whether the tax is fairly apportioned; (3) whether application of the tax discriminates against interstate commerce; and (4) whether the tax is fairly related to the services provided by the state (***id.*** at 279). Petitioner's challenge to the application of New York's corporation tax encompasses only the "substantial nexus" prong of the ***Complete Auto*** test.

The Supreme Court's most recent pronouncement on the substantial nexus question came in ***Quill Corp. v. North Dakota*** (504 US 298, 119 L Ed 2d 91). That case involved a mail order vendor having substantial sales in the taxing state but whose only connection with its North Dakota customers was by common carrier or United States mail. The vendor solicited sales for office equipment and supplies through catalogs, flyers, advertisements in national periodicals

and telephone calls. It had a substantial economic presence in the taxing state. The trial court found that the vendor had annual national sales of $200,000,000.00, of which almost $1,000,000.00 in sales were made to North Dakota customers. It was the sixth largest supplier of office equipment in North Dakota. Title to the merchandise, shipped by common carrier from out-of-state locations, passed in North Dakota.[5] The State Court emphasized that North Dakota had created an economic climate that fostered a demand for the vendor's products, maintained a legal infrastructure that protected the market, and disposed of approximately 24 tons of the vendor's catalogs and flyers each year. Declining to follow the Supreme Court's earlier precedent in ***National Bellas Hess v. Department of Revenue*** (386 US 753, 18 L Ed 2d 505), the State Court concluded that physical presence was no longer necessary in the case of a mail order vendor who systematically directs its marketing efforts at the taxing State and that substantial nexus might be found in a vendor's systematic economic exploitation of the State market. The Supreme Court reversed although it agreed with the State Court in part. Thus, it overruled so much of ***Bellas Hess*** as required some physical presence of the vendor in the taxing state to support jurisdiction to tax under the due process clause and affirmed that only a minimal connection with the taxing state was required. However, it continued to adhere to that portion of the ***Bellas Hess*** precedent that required some physical presence of the vendor in the taxing State for validity under the Commerce Clause.[6]

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[5] North Dakota argued at trial that Quill retained title to the merchandise during a 90-day guarantee period, but the trial court held that title passed when the merchandise was delivered to the customer. (***Id.*** at 302, fn 1.)

[6] The ***Quill*** opinion seems to suggest that the nexus standard as applied to the duty to collect sales and use taxes may be different from the standard as it applies to a tax measured by income (***Quill Corp. v. North Dakota***, ***supra***, 504 US at 314). However, the holding in ***Quill*** explicitly relies on and reaffirms the vitality of the substantial nexus requirement expressed in ***Complete Auto,*** which is applicable to franchise and income taxes.

K. There is no question that petitioner regularly and continuously availed itself of the New York market for natural gas during the audit period. Its economic presence within the State establishes that there was more than a minimal connection between the activity being taxed and New York. For that reason, the due process clause does not create an obstacle to New York's taxation of petitioner's gross receipts. Petitioner concedes as much. However, ***Quill*** requires physical presence within the taxing state irrespective of the degree to which the vendor engages in exploitation of the consumer market of the taxing state. Accordingly, the determinative issue here is whether petitioner had a physical presence in New York State during the audit period.

L. Shortly after ***Quill*** was issued, the New York Court of Appeals was asked in ***Orvis Co. v. Tax Appeals Tribunal*** (86 NY2d 176, 630 NYS2d 680, ***cert denied*** 516 US 989, 133 L Ed 2d 426) to consider the impact of the ***Quill*** decision on New York's jurisdiction to impose a duty to collect sales tax on two interstate vendors. After surveying the decisional law, the Court of Appeals concluded that the substantial nexus prong of the ***Complete Auto*** test requires physical presence of the interstate vendor in the taxing state. It defined the degree of physical presence required as follows:

> While a physical presence of the vendor is required, it need not be substantial. Rather, it must be demonstrably more than a 'slightest presence' (***see***, ***National Geographic v. California Equalization Bd.***, 430 US 551, 556 97 S Ct 1386, 1390, ***supra***). And it may be manifested by the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf. (***Orvis Co. v. Tax Appeals Tribunal***, ***supra***, 630 NYS2 at 687).

The standard articulated in ***Orvis*** provides the relevant inquiry in this proceeding to determine whether petitioner had demonstrably more than a slightest physical presence in New York State. Petitioner had no employees, agents or independent contractors conducting activities in New York State on its behalf; therefore, if physical presence is to be found it is because of

"the presence in the taxing State of the vendor's property" (***id.***). Petitioner did not own or lease real property in New York State, did not have warehouse or storage facilities in New York State, had no intangible property in New York State, and it did not own tangible property in New York State. Accordingly, it had no physical presence in New York and, for that reason, lacked substantial nexus with New York.

M. The Division's arguments in support of taxation are rejected as without merit. The Division claims that petitioner "was physically present in the State through its property located within the State *on a daily basis*, 365 days a year throughout the period in issue" (Division's brief, p. 21; emphasis in original). In fact, petitioner's ownership of natural gas in New York on a continuous basis is the only possible basis for a finding of physical presence. Petitioner argues that such ownership does not even amount to a slightest physical presence, and I agree.

Something more than ownership of tangible property while it is in the custody of a common carrier is required to make a finding of physical presence. Unless explicitly agreed to by the buyer and seller, title to goods normally passes upon delivery to the buyer (Uniform Commercial Code § 2-401[2]), yet, in the mail order cases reviewed here, the courts have not inquired into ownership of the property which is the subject of the sale. In ***Orvis***, an audit disclosed that the company had annual sales in New York of $1 million to $1.5 million which were shipped by common carrier from Vermont. Where title to that merchandise passed was not considered a significant factor in determining nexus. The Division did not allege that Orvis's ownership of that property prior to its delivery to the ultimate customer was a factor to be considered. In ***Quill***, the trial court held that passage of title to merchandise passed in North Dakota when the merchandise was delivered. Quill's ownership of the merchandise while it was en route did not constitute physical presence, and, again, it was not even a factor considered by

the Court. Even if title to the gas passed at metering stations located miles from the international border, petitioner's ownership of the gas after it was delivered to a pipeline for delivery would not constitute physical presence in New York.

The Division argues that consummation of sales and transfer of title to goods in New York is sufficient to create substantial nexus. A survey of the relevant cases does not support this proposition. In a case relied on by the Division, the Court held that "a sale of tangible goods has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State." (***McGoldrick v. Berwin-White Coal Mining Co.***, 309 US 33, 84, 84 L Ed 565). However, the vendor in ***Berwin-White*** maintained a sales office in New York, executed contracts for the sale of coal in New York and delivered the coal to its New York customers using its own barges. A later Court decision, ***McLeod v. Dilworth*** (322 US 327), invalidated an Arkansas sales tax imposed on a Tennessee merchant who maintained no offices or other property in the taxing State. In doing so, the Court explicitly distinguished ***Berwin-White*** on the ground that the coal mining company maintained sales offices in New York City, executed contracts in New York City and made the deliveries to New York City. In ***National Geographic v. California Equalization Bd.*** (430 US 551, 51 L Ed 2d 631), the Court upheld a use tax collection obligation with respect to mail order sales from National Geographic's home office in Washington, D.C. The Court found sufficient physical presence on the basis of two National Geographic advertising sales offices in the taxing State. The significance of that ruling was the Court's holding that the required nexus need not be directly related to the activity sought to be taxed and that only the "slightest presence" is required to find substantial nexus with the taxing state (***id.*** at 556). It did not base its finding of nexus on the existence of sales

consummated in California or the passage of title to goods in California; rather, it relied on the physical presence of the National Geographic society in California.

The only court case supporting the Division's position is an opinion of the Oklahoma Supreme Court, ***Koch Fuels v. State of Oklahoma*** (862 P2d 471). In a situation similar to the one obtaining here, the Oklahoma court found that delivery and transfer of title in the taxing state created the required substantial nexus. Although ***Koch*** was issued after the Supreme Court issued its decision in ***Quill***, the ***Koch*** opinion does not address the physical presence requirement of ***Quill*** (***cf.***, ***Matter of Orvis Co. v. Tax Appeals Tribunal***, ***supra*** [where the New York Court of Appeals concluded that physical presence is a requirement under ***Quill*** and set forth a standard for determining physical presence in New York]). Moreover, the Oklahoma Court found that Koch was qualified to do business in Oklahoma and, by failing to present evidence on the issue, failed to establish lack of sufficient presence to challenge the tax. In contrast, petitioner presented sufficient evidence to show that it lacked physical presence in New York under the standard established in ***Orvis v. Tax Appeals Tribunal*** (***supra***). For all these reasons, I decline to follow the Oklahoma Supreme Court's reasoning in ***Koch***.

Other cases cited by the Division are distinguishable both because they were decided well before ***Quill*** was issued and because the foreign corporation had a substantial physical presence in the taxing state. In ***Utah State Tax Commn. of Utah v. Pacific States Cast Iron Pipe Co.*** (372 US 605, 10 L Ed 2d 8), Utah's imposition of tax on sales made to customers of a Nevada corporation located outside of Utah was upheld where the Nevada company qualified to do business in Utah and had manufacturing facilities in Utah. ***International Harvester Co. v. Department of Treasury*** (322 US 340, 88 L Ed 1313) involved a corporation authorized to do business in Indiana but incorporated under the laws of another State. The Court upheld Indiana's

imposition of sales tax where the foreign corporation had manufacturing plants and sales offices in the taxing State, orders were solicited in the taxing State and customers took delivery of merchandise in the taxing State. In the one case U.S. Supreme Court decided after ***Quill***, the vendor's physical presence in the taxing State was established and was not the issue in dispute (***Oklahoma Tax Commn. v. Jefferson Lines***, 514 US 184, 131 L Ed 2d 261). A Minnesota bus company doing business in Oklahoma sold and collected sales tax on tickets for bus travel that originated and terminated in Oklahoma, but it did not collect sales tax on tickets it sold for bus travel originating in Oklahoma and terminating in another State. The Court held that the first part of the ***Complete Auto*** four-part test was satisfied where service originated in Oklahoma and the tickets were purchased there.

K. I agree with petitioner that the test for physical presence in New York State was established in ***Orvis*** and is established by "the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf." (***Orvis Co. v. Tax Appeals Tribunal***, ***supra***, 630 NYS2d at 687.) Petitioner had no personnel in New York State. It had no property in New York State. It transferred title to natural gas in New York at the same time that custody was transferred from a Canadian pipeline to a pipeline located in New York. Petitioner's very brief ownership of the gas and transfer of title in New York is not sufficient to establish even a "slightest presence" in New York. Therefore, imposition of the gross receipts tax on petitioner's sales is barred by the Commerce Clause.

L. The petition of Wascana Energy Marketing (U.S.) is granted, and the Notice of Deficiency issued on January 10, 2001 is canceled.

Dated: Troy, New York
July 18, 2002

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE